No. 12550

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
MAY CHANDLER GOODAN, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
MARIAN OTIS CHANDLER, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
NORMAN CHANDLER, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
PHILIP CHANDLER, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
CONSTANCE CHANDLER CROWE, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
HELEN CHANDLER GARLAND, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
RUTH C. WILLIAMSON, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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OPINION BELOW

The opinion of the Tax Court (R. 30-70) is reported at 12 T. C. 817.

JURISDICTION

These petitions for review involve income taxes for the calendar years 1938, 1939, 1940 and 1941. (R. 82-83,

106-107, 132-133, 158-160, 185-186, 208-209, 233-234.) On June 30, 1943, the Commissioner of Internal Revenue mailed notices of deficiency to the taxpayers herein. (R. 8-9, 92-93, 116-117, 142-143, 171-172, 195-196, 219-220.) Within ninety days thereafter, i. e., on September 27, 1943, the taxpayers filed their petitions with the Tax Court for redetermination of the deficiencies under Section 272 of the Internal Revenue Code. (R. 2-16, 86-101, 110-127, 136-154, 163-179, 189-203, 212-228.) The Tax Court entered its decisions on May 24, 1949, but inasmuch as the Commissioner filed a motion to vacate the decisions and also a motion to reconsider and set aside the Tax Court's findings of fact and opinion, hearing was held on such motions on June 13, 1949, and the decisions were vacated on August 15, 1949, pending further consideration of the motions. (R. 74.) After such consideration, the Tax Court decided to reenter the vacated decisions (R. 80) and on November 30, 1949, entered an order denying the Commissioner's motions (R. 75). Accordingly, the Tax Court adopted the deficiencies and overpayments which it had originally approved. For individual decisions see the record at pages 81, 105, 131, 157-158, 184, 207 and 232.[1] The petitions for review by this Court were filed February 17, 1950 (R. 82-83, 106-107, 132-133, 158-160, 185-186, 208-209, 233-234), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.[2]

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[1] Some of the decisions printed in the record are dated as entered May 24, 1949, and others as entered November 30, 1949. As explained above, the original decisions entered May 24, 1949, were vacated and the identical decisions were later reentered on November 30, 1949. The petitions for review relate to the November 30, 1949, decisions. Apparently in some of the cases, the earlier decisions were erroneously printed but except for date they are substantially the same as the decisions appealed from.

[2] The record erroneously gives (R. 107) the date for filing the petition for review in the case of Marian Otis Chandler as November 17, 1943, but the correct filing date is that given above.

QUESTIONS PRESENTED

1. Whether the taxpayers who are the grantors, trustees and principal beneficiaries of the family trust involved here are subject to tax under Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code on taxable stock dividends which were received by the trust in the taxable years and were added by the trustees to the corpus of the trust.

2. Whether such stock dividends were taxable to the taxpayers herein as grantors of the trust under Section 167 of the Revenue Act of 1938 and the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the applicable statutes and Regulations involved are set forth in the Appendix.

STATEMENT

The facts as found by the Tax Court (R. 31-50) are as follows:

The trust involved herein, Chandler Trust No. 2, was created on June 26, 1935, by a trust agreement which was executed by the taxpayers and Harrison G. O. Chandler, all of whom are not only trustors but also trustees. At no time since its execution has the trust agreement been altered, amended or modified. (R. 31.)

Marian Otis Chandler (one of the taxpayers here) is the mother of Harrison G. O. Chandler and the other six taxpayers. On June 26, 1935, she was 68 years of age, her children ranged from 42 to 28 years of age, and her 13 grandchildren from 18 years to two months. All of these individuals are living at the present time, except one grandchild, who died in June, 1943. (R. 31.)

At the time the trust agreement was executed Marian Otis Chandler conveyed to the present trustees

and their successors 16,536 shares of stock of Chandis Securities Company, hereinafter referred to as Chandis. Each of the other seven trustors conveyed to the present trustees and their successors a certificate representing 50 shares of stock of The Times-Mirror Company, hereinafter referred to as The Times, and each also conveyed two certificates representing 2,694 shares of stock of Chandis. The certificates of stock were endorsed by the respective trustors on June 27, 1935, and delivered to The Times and Chandis for cancellation. A new certificate representing 350 shares was issued by The Times and a new certificate representing 35,394 shares was issued by Chandis in the names of, and delivered to, the trustees on June 27, 1935. From that date to the present time, the trustees (who are the taxpayers here) have kept the certificates. (R. 31-32.)

The trust indenture, after specifically naming the taxpayers and Harrison G. O. Chandler as "the Trustors", as "the 'present Trustees'" and as "the 'present beneficiaries'", states the purpose as follows (R. 32-33):

> That, Whereas the Trustors deem it to be for their best interest, and for the best interests of The Times-Mirror Company and the Chandis Securities Company, that there should be a continuity and stability of policy and management, and to that end that the interests of each of the Trustors in said corporations, as evidenced by the stock severally held by them, be united and vested in the Trustees, as hereinafter provided; and
>
> Whereas, the Trustors deem it also to be for their best interests that there should be held, conserved, administered and eventually distributed, according to the terms hereof, those assets which are respectively contributed by them to the Trust Estate;
>
> *   *   *   *   *

Article I of the trust indenture segregates the trust corpus into two parts by providing that one part (R. 33)—

> * * * shall consist of all of the shares of capital stock of The Times-Mirror Company delivered to the Trustees hereunder, and the other part shall consist of all of the shares of the capital stock of Chandis Securities Company delivered to the Trustees hereunder, and such division and segregation shall be continued throughout the term of this trust.

Article I also provides that the legal and equitable title to the trust estate is to be vested in the trustees and that no interest therein (R. 33)—

> is, or at any time shall be, deemed to be vested in any of the beneficiaries hereunder. The interests of the beneficiaries shall at all times consist only and solely of the right to enforce the due performance of this trust.

Article II, which deals with the gross income from the trust, provides that gross income from each division of the trust estate (The Times stock and the Chandis stock) shall be charged with the taxes, costs, charges and expenses applicable to administering, protecting and distributing that portion of the trust estate. General and indirect costs, charges and expenses were to be allocated to the two parts as the trustees determined. (R. 33-34.)

Article III, dealing with the distribution of the net income, provides that the (R. 34)—

> entire net income received from the trust estate and available in cash for distribution, shall be paid in monthly, quarterly, or other convenient installments

as the trustees may from time to time determine. The net income from The Times stock is to be distributed

in equal shares to the seven individuals who contributed that stock and the net income from the Chandis stock to be distributed during the lives of the eight trustors in proportion to the stock of that company which each had contributed. (R. 34.)

Article III also provides as follows (R. 34-35):

> There is hereby expressly reserved to each of the Trustors, during his or her lifetime, the absolute power of appointment and disposition of his or her share of the principal and income of the Trust Estate after his or her death, the same to be exercised not by Will, but only by the last written instrument exercising such power on file with the Trustees at such Trustor's death. Such power may be exercised, but only in the manner herein specified, from time to time, and each exercise thereof may be similarly revoked.

Failing such appointment and disposition so on file at the time of trustor's death, the trust income to which a deceased trustor would have been entitled is to be distributed to his or her spouse for life, then to their issue, if any, then to the living heirs of such trustor, during their respective lives until termination of the trust. Similarly, the trustor's share of principal upon termination of the trust is vested in and distributed to his or her then living issue in equal shares, *per stirpes,* if none survived then to the living heirs-at-law, the identity and respective shares of which is to be determined by California law in force at the time of the trustor's death. (R. 35.)

Article IV provides that the trust (R. 35)—

> shall cease upon, and in no event shall its duration extend beyond, the death of the last survivor of the following named persons, * * *.

The 21 persons named in the trust indenture were the eight trustors and 13 grandchildren referred to above. (R. 35.)

Article V, entitled "As to Trustees", provides that when the "present Trustees" shall have been reduced to three in number, the survivors shall appoint and constitute additional trustees so that there shall always be, except for temporary vacancies, seven trustees until the termination of the trust. The additional trustees were to be selected, so far as possible, from the then beneficiaries of the trust, "giving preference to those who may be executives of" The Times and Chandis, "so long as shares of stock of the respective companies are held in the Trust Estate". Other persons, including a bank or trust company, could be selected as additional trustees, but a majority of the trustees who were at the same time beneficiaries, could remove any or all of such other persons. Long continued absence from the County of Los Angeles, or California, or incapacity or inability to act constituted valid reasons for removal of any trustee by the remaining trustees, whether a beneficiary or not. Except in instances where unanimity or determination by trustees who are also beneficiaries is specifically provided, the decision of a majority of the trustees shall be deemed the decision of all. (R. 35-36.)

The trustees are authorized to choose a chairman and a secretary from their number and also one or more special custodians of funds or property, and one or more for the collection and disbursement of funds of the trust estate. The trustees can appoint other agents, depositaries, auditors, advisers, brokers, attorneys and consultants. They are required to adopt rules of procedure for their meetings, keep records, fix regular places and times for meetings with provision for notice thereof, all as they may from time to time determine in the efficient administration of the trust estate. The books of account, minutes of meetings and other records of the trust are to be subject to inspection to such extent

as the trustees may from time to time determine. (R. 36.)

Article VI, entitled "Powers of the Trustees", provides as follows (R. 37-44):

> The Trustees are specifically empowered to receive and collect the principal and income of the Trust Estate, invest and reinvest the principal available therefor, and as hereinabove provided, to pay, accumulate, use and apply the income, and at the termination of the trust, to distribute the principal of the Trust Estate.
>
> To carry out the express purposes of this trust, and in aid of its execution, and the proper administration, management and distribution of the Trust Estate, the Trustees are vested with the following additional powers and discretions:
>
> > (1) The shares of stock [of] The Times Mirror Company, hereinabove described, and the shares of stock of Chandis Securities Company, hereinabove described, shall be sold, exchanged, or otherwise disposed of only by the unanimous decision of the present or succeeding Trustees herein named; after the present and succeeding Trustees herein named are reduced to three in number, by the unanimous decision of the Trustees who are then beneficiaries hereunder;
> >
> > (2) Similar unanimity shall be required for a determination of the Trustees to borrow upon or pledge, or in any manner hypothecate or alienate or transfer or otherwise dispose of any interest in or to said shares. No portion, or less than the entire number of said shares, shall be sold, pledged, or otherwise disposed of, except in the event of such emergency that such partial disposition shall serve to avert the loss of the whole, or to protect the remaining shares.
> >
> > In aid of the determination to be arrived at by the Trustees in the situations herein contemplated, it is the Trustors' desire and request that

the powers herein conferred, which are contingent upon the unanimous decision of the Trustees, shall be exercised only to maintain such a proportionate interest as is now represented in The Times Mirror Company and Chandis Securities Company, or in the event of an emergency, to protect as much thereof as may be possible under such circumstances;

(3) It being the desire of all the parties hereto that Norman Chandler shall eventually succeed to the position of President and General Manager of the Times Mirror Company, the Trustees shall vote said shares for such Directors as will carry out this desire. The unanimous decision of the Trustees shall be required in order to vote for such Directors as will not choose Norman Chandler as the President and General Manager of the Times Mirror Company, but if it should be unanimously determined that some one other than Norman Chandler shall be President and General Manager of The Times Mirror Company, then a decision by a majority of the Trustees shall be sufficient to choose his successor;

(4) The unanimous decision of all of the Trustees shall be requisite to exercise the following powers with reference to the stock of The Times Mirror Company and Chandis Securities Company, so long as it shall constitute a part of the Trust Estate:

(a) To vote for any increase of capitalization of The Times Mirror Company and/or Chandis Securities Company, which increase is proposed to be sold to the stockholders, or others, and not issued by way of stock dividend;

(b) To vote for or consent to the incurring of any bonded indebtedness or other long term loan which requires the approval of stockholders, or shall be submitted to them;

(c) To vote for or consent to any new classes of stock, or any reclassification of stock which might vary the rights of stockholders as to voting or other preferences;

(d) To enter into any voting trust or other lawful agreement with other stockholders for the purpose of concentrating or unifying the control of stock of The Times Mirror Company and/or Chandis Securities Company, and to deposit shares under such agreement;

(5) The Trustee, if the shares of stock of The Times Mirror Company and/or Chandis Securities Company should be sold or otherwise disposed of, or if there should be any liquidation, partial or otherwise, of the assets thereof, or a distribution to the stockholders thereof of any proceeds of sale as a result of which assets of substantially different character are received by the Trustees, then and in that event, but not otherwise, are vested with the following additional powers and discretions:

(a) To retain such property and to continue to operate any business in connection therewith for such time as the Trustees may deem advisable or expedient;

(b) To manage, control, sell, convey, exchange, or otherwise dispose of, or partition, divide, sub-divide, improve or repair such property and in connection with its disposal, to grant options and to sell upon deferred payments;

(c) To borrow upon, mortgage, pledge, or otherwise encumber such property;

(d) To lease such property, or any part thereof, for terms extending beyond the duration of this trust, and to grant for like terms the right to mine, or drill for and remove therefrom gas, oil and other minerals;

(e) Respecting bonds, shares of stock and other securities, notes, accounts and other choses in action, to have and exercise all the rights, powers and privileges of an owner, including (though without limiting the foregoing) voting, giving of proxies, payments of assessments and other sums deemed by the Trustees to be expedient for the protection thereof, assenting to corporate sales, leases and encumbrances, participating in voting trusts and pooling agreements, selling or exercising stock subscription or conversion rights, participating in foreclosures, reorganizations, mergers and liquidations, and in connection therewith depositing securities with protective or other committees, on such terms as the Trustees may deem expedient; to sue upon or otherwise enforce collection of any note or other obligation, or to compromise any claim or demand based thereon;

(f) To invest such principal receipts as are in the form of cash in conservative securities to such an extent as the Trustees shall deem advisable or expedient, but such investment of cash shall not be limited to conservative securities if the Trustees shall deem that any one or more of the following courses shall better protect the Trust Estate, or shall be more conservative as providing for a greater diversification:

(1) To purchase property, whether real or personal, to such extent as the Trustees may deem expedient or desirable, as providing protection from the possibility of monetary disorders or securities devaluations or deflations, or monetary or other inflation, or to avert or lighten onerous taxes or other Governmental charges;

(2) To make such conservative loans or advances upon collateral or upon real estate for such term, either within or extending

beyond the duration of this trust and at such rate of interest as the Trustees may deem to be for the best interests of the Trust Estate;

The enumeration of those certain powers and discretions of the Trustees, as are set out in this Paragraph (5) shall not be construed as limiting the general powers and discretions herein vested in the Trustees, it being the intent of the Trustors that in the events provided for in this Paragraph, the Trustees shall have, and they are hereby vested with, all of the powers and discretions that an absolute owner of property has or may have.

(6) Regardless of the character of the Trust Estate, the Trustes [Trustees] shall have the following general powers and discretions:

(a) To determine in their discretion what is principal of the Trust Estate, gross income or net distributable income therefrom; except that all bonuses, royalties and recoveries from mines, gas or oil leases or wells, all stock dividends and proceeds of sale of stock rights and all gain or loss which may result from the payment, retirement or sale of stocks, notes, bonds or other securities, or on foreclosure or other realization upon mortgages and trust deeds, shall inure to or fall upon principal, and all cash dividends (other than liquidating dividends stated in writing to be such by the corporation paying the same, or proved to the satisfaction of the Trustees to be such prior to its disbursement thereof) shall go to income of the Trust Estate. The net income from real property acquired by the Trustees on or by acceptance of conveyance in lieu of foreclosure, shall go to income of the Trust Estate. Brokers' or other commissions and expenses on purchase or sale of trust property shall be charged against principal;

(b) To hold property of the Trust Estate in their own names, or in the names of one or more of their number, or in the name of their nominee, with or without disclosing such fiduciary relationship;

(c) To appoint or employ servants, including agents, auditors, brokers, attorneys and other consultants and advisers, and provide for their compensation;
Any Trustee who is not a beneficiary may receive such reasonable compensation for his services as Trustee, as the remaining Trustees may agree upon at the time of his or its appointment. Any Trustee may be compensated for any special or extraordinary or unusual services if such compensation shall be agreed upon in advance of the rendition of such services;

(d) The Trustees may maintain and administer the Trust Estate undivided and as a unit, and shall not be required to make physical division or segregation thereof, except if, when and to the extent required to make distribution thereof, as in this trust provided, but the Trust Estate shall be deemed to be theoretically divided into as many units as there are beneficiaries and in proportion to their respective interest in the income;

(e) To allot, partition and distribute the Trust Estate for such valuations and according to such method or procedure as the Trustees may determine upon, and to do so in kind, or partly in kind and partly in money, according to their valuation thereof;

(f) To construe this agreement, and the construction of the same made in good faith shall be final, conclusive and binding upon all beneficiaries;

All discretions in this trust conferred upon the Trustees shall, unless specifically limited, be ab-

> solute and their exercise shall be conclusive on all persons interested in this trust or the Trust Estate.

Article VII, entitled "Liabilities of the Trustees", specifies that the trustees assume no personal liability in respect of any action taken by them, except for gross negligence or willful misconduct. It also provides that any trustee may be a member, shareholder, director, officer or trustee of any other corporation, firm, trust or association with which the trustees may deal; may become pecuniarily interested in any matter or transaction to which the trustee may be a party, provided the nature of such relationship is fully disclosed to the remaining trustees; may buy from, sell to, or deal with the trustees so long as a majority of all the trustees have notice of such interest of such trustee in the transaction and shall approve thereof. The trustees shall render to the beneficiaries an annual statement of receipts, disbursements and assets as soon after the close of the fiscal period as practicable. The approval of such account by the adult beneficiaries competent to act constitutes a full and complete acquittance and discharge of the trustees as to the transactions, receipts and disbursements reflected therein. (R. 44-45.)

Article VIII is entitled "As to Beneficiaries". It contains provisions restraining each beneficiary from alienating, anticipating, encumbering or in other manner assigning his or her interest, and other provisions common to so-called spendthrift trusts. (R. 45.) It also provides in part as follows (R. 45-46):

> If any beneficiary shall, either directly or indirectly, singly or in conjunction with other persons, seek to establish or assert any claim to the Trust Estate or to the income therefrom except as it herein specifically provided, or shall attempt to impair, invalidate or set aside any of the provi-

sions hereof, or to have the same or any part thereof declared void or diminished, or to defeat or change any part of the plan of administration and distribution, as contemplated hereby, or shall attempt to settle or compromise, directly or indirectly, either in or out of court, with any persons seeking so to do, or shall consent or acquiesce in, or fail to contest such proceedings, then and in that event, anything to the contrary hereinabove stated notwithstanding, such person or persons shall thereupon cease to have any further interest or estate hereunder and the interest or share which would otherwise have gone to such person or persons shall go to augment the share or shares of those who shall not have joined in, assisted, consented to or acquiesced in such proceedings.

The beneficiaries hereunder shall have no control or authority over the Trustees in any particular whatsoever, their entire interest hereunder being to receive the income, and at the termination of this trust, the principal, in the manner and to the extent determined by the Trustees. The acts of the Trustees and the powers and discretions herein vested, shall, except for lack of good faith, be conclusive upon all beneficiaries hereunder.

Article IX is entitled "General Provisions". It provides that persons dealing with the trustees shall not be required to see to the application of the purchase money or other consideration passing to the trustees and were not required to see that the terms of the trust were complied with. The provisions of the trust agreement are declared to be severable, and the adjudged invalidity of any provision was not to effect the remaining provisions of the trust agreement. (R. 46.) The concluding paragraphs of Article IX provided as follows (R. 47):

This agreement and each and every provision hereof shall be, and is hereby, declared to be irrevocable and cannot be terminated by the parties

> hereto, by the beneficiaries hereunder, or by any court or otherwise, prior to the expiration of its full term, as herein fixed;
>
> Provided, however, that the Trustors, during their joint lives, have reserved, and do hereby reserve, the right by their unanimous agreement in writing and filed with the Trustees to modify, amend, construe, define or otherwise vary the terms of the provisions of Articles II, III, V, VI, VII and IX hereof, but no such modification shall be effective, directly or indirectly, to change the provisions as to the duration of this trust or the initial character of the Trust Estate, as provided in Articles I, IV, and VIII, the provisions of which last numbered Articles shall be in all respects and in each and every provision thereof be and remain irrevocable.

The total property owned by the trust during the taxable years consisted of (a) a small amount of cash; (b) 350 shares of stock of The Times; (c) 35,394 shares of common stock of Chandis; and (d) shares of preferred stock of Chandis, increasing from 884 shares at the end of 1937 to 3,541 shares at the end of 1941. (R. 47.)

The gross cash receipts of the trust for the taxable years are as follows (R. 48):

Cross Cash Receipts	1938	1939	1940	1941
Dividends on Times stock...	$26,950.00	$32,375.00	$35,000.00	$35,000.00
Dividends on Chandis stock.	62,918.30	54,343.81	61,501.23	77,692.39
Total.................	$89,868.30	$86,718.81	$97,501.23	$112,692.39

The expenditures of the trust include small amounts paid for part-time clerical services in keeping the trust's books and records and amounts paid for California State income tax. (For exact amounts see R. 48.)

During the taxable years the trust received, as taxable stock dividends on its Chandis common stock, the following number of shares of Chandis preferred

stock, which had a fair market value equal to its par value (R. 48):

Year	Number of Preferred Shares	Fair Market Value
1938	707	$70,000.00
1939	707	70,700.00
1940	707	70,700.00
1941	530	53,000.00

The trust reported these stock dividends on its income tax returns (R. 48) and paid the taxes thereon as follows (R. 49):

1938	$27,220.00
1939	17,942.00
1940	17,942.00
1941	26,404.40

The above income taxes were paid with cash contributed by the taxpayers in accordance with their respective interests in the trust. (R. 49.)

The net cash income distributable and distributed under the terms of the trust agreement to the respective beneficiaries (who were also trustees and grantors of the trust here) was reported by the beneficiaries in their respective income tax returns and taxes were paid by them on such amounts individually. For the sums distributed see the record at page 49. (R. 49.)

The principal business of The Times is, and since 1881 has been, the publication of "The Los Angeles Times", a newspaper with daily morning and Sunday editions. It has one class of stock, of which 5,760 shares were outstanding during the taxable years. At all times since 1884 a majority of the stock of The Times has been owned, directly or indirectly, by the father of Marian Otis Chandler, General Harrison Gray Otis, and his descendants. (R. 49.) Immediately prior to the creation of the trust on June

26, 1935, shares of stock of The Times were owned as follows (R. 50):

Name of Stockholders	No. Shares
Marian Otis Chandler	1,634
May C. Goodan	50
Ruth C. Williamson	50
Helen C. Garland	50
Harrison G. O. Chandler	50
Philip Chandler	50
Constance Chandler	50
Norman Chandler	100
Estate of Frances C. Kirkpatrick	50
Harry Chandler	3
Chandis Securities Company	1,935
Others	1,738
Total	5,760

Chandis, which was a personal holding company during the years involved herein, was organized in 1916. On June 25, 1935, its outstanding stock consisted of 38,288 shares of common stock. Of these Marian Otis Chandler owned 16,536 shares, her seven living children and the estate of her deceased daughter each owned 2,694 shares, and Harry Chandler owned 200 shares. Preferred stock of Chandis was first authorized and issued in 1937, and on December 31, 1941, there were 5,954 shares of such preferred stock outstanding. The purpose of Chandis in authorizing and issuing taxable stock dividends during the taxable years was to enable it to obtain dividends paid credits and at the same time retain a portion of its earnings in order to liquidate its outstanding obligations and those of its wholly-owned subsidiary, Southwest Land Company. (R. 50.)

The Tax Court reached the conclusion (1) that the taxpayers here created a valid trust; (2) that they are not taxable under Section 22 (a) of the applicable revenue laws on that part of trust income consisting

of the stock dividends; (3) that the trust is not revocable under Section 166 of such laws; and (4) that the trust income, in so far as the stock dividends are concerned, was not being held or accumulated for future distribution for the benefit of the grantors within the meaning of Section 167. Consequently, it was decided that the stock dividends (the only income involved here) were not taxable to the taxpayers. (R. 51-69.)

Four of the Tax Court Judges dissented from this decision and joined in a dissenting opinion in which it was stated in substance that the powers retained by the taxpayers as grantors in Article IX of the trust indenture gave them such powers over the trust corpus that they should be held taxable on the stock dividends involved here. (R. 70.)

STATEMENT OF POINTS TO BE URGED

1. The Tax Court erred in not holding that the taxpayers are taxable under Section 22 (a) of the Revenue Act of 1938 and the Internal Revenue Code on the stock dividends received by the trust during the taxable years.

2. The Tax Court erred in holding that the taxpayers are not taxable on such stock dividends under Section 167 of the Revenue Act of 1938 and of the Internal Revenue Code.

3. The Tax Court erred in not sustaining the deficiencies determined by the Commissioner in the income taxes due from each of the taxpayers here.

SUMMARY OF ARGUMENT

1. The Tax Court erroneously held that the trust and not its eight grantors (seven of whom are taxpayers here) should be taxed on the stock dividends which were received and retained by the trust in the taxable years and which are admittedly subject to income tax. Despite

the trust form, in substance they remained the real owners of the corpus, including the stock dividends in question, because of the large bundle of rights they continued to have therein. Each grantor reserved the right to receive all of his share of trust income for life and the absolute power to appoint the corpus to any beneficiary, including his estate, thus enabling him to anticipate and enjoy the equivalent of the stock dividends during his life. The trust was voluntarily created by eight closely related members of a family which controlled the two corporations, the stocks of which formed the corpus, for the grantors' own "best interests"—primarily to assure the presidency and general managership of the Times-Mirror Company for Norman, one of the grantors and thus insure their managing control of that corporation. The grantors were also trustees and principal beneficiaries, indeed the only beneficiaries with vested and indefeasible interests. The benefits the trust gave to control the corporations at all times was patently more important to the taxpayers than any right individually as minority stockholders to vote their stock, which they surrendered. As trustees taxpayers had broad powers indicating that they were not intended to act in a real fiduciary capacity and giving them comprehensive control over the corpus. As grantors they had power unanimously to amend the trust agreement in many respects and thereby could cause the distribution of the stock dividends in question to themselves. The circumstance that many of their powers as trustees and the power to amend could be exercised only by unanimous action is not significant because the record here indicates that their interests were identical and that their views would be harmonious. Accordingly, it is clear that taxpayers remained the substantial owners of the property, despite the imposition of the trust form.

2. The stock dividends are also taxable to the taxpayers under Section 167 of the Revenue Act of 1938

and the Internal Revenue Code, which taxes the grantor of a trust on that part of trust income which, in his own discretion or that of any person having no substantial adverse interest in the disposition of such income, may be distributed to, or may be held for future distribution to the grantor. The grantors' power unanimously to amend the trust and take the stock dividends for themselves brings the stock dividends within this section, since no one grantor had any adverse interest in the disposition of the dividends allocable to the trust share of any other grantor. The power of each grantor, held and exercisable individually, to appoint his share of the corpus, including the stock dividends, effective after his death, also makes Section 167 applicable since the grantor could appoint his estate or even a creditor to take the corpus, and thus he could enjoy the equivalent of the dividends during his lifetime.

ARGUMENT

I

The Tax Court Erroneously Held That the Stock Dividends Received by the Trust During the Taxable Years Could Not Be Taxed to the Grantors of the Trust under Section 22 (a) of the Revenue Act of 1938 and the Internal Revenue Code

The only question in this case is whether the stock dividends which are admittedly subject to income tax and which were received by the trust during the taxable years should be taxed to the eight grantors (seven of whom are taxpayers here) as the Commissioner determined, or to the trust as the Tax Court held. We submit that such dividends should be taxed to the grantors and that, in holding otherwise, the Tax Court has not only erroneously construed and applied pertinent provisions of the revenue law but has also incorrectly interpreted the provisions of the trust agreement here.

It is our first contention that authority for taxing the stock dividends to the grantors is found in the broad provisions of Section 22 (a) of the Revenue Act of 1938 and the Internal Revenue Code (Appendix, *infra*) which defines gross income as including gains, profits and income "of whatever kind and in whatever form paid". It is of course well established now that where a grantor of a trust retains in the property such rights as to make him in substance the owner of the property, he must be taxed under Section 22 (a) on the income of such trust regardless of whether the income is actually received by him; and it is our position that the provisions of the trust here bring this case within Section 22 (a). See *Gaylord* v. *Commissioner,* 153 F. 2d 408, 412-413 (C.A. 9th).

The leading case on this point is *Helvering* v. *Clifford,* 309 U. S. 331, in which the grantor of a trust was held taxable under Section 22 (a) on the trust income paid to his wife as the beneficiary entitled to receive all of the income. The trust there was to continue for a term of five years or until the prior death of the grantor or his wife, and upon termination of the trust, the corpus was to go to the grantor or to his estate but any undistributed income was to be treated as the wife's property. The grantor was named trustee with broad powers of control over the trust property. In holding the grantor liable for the tax, the Supreme Court pointed out that since he retained so many of the attributes of ownership, the creation of the trust had not caused any substantial change in his economic status and had left him for all practical purposes with most of the control which he had possessed as an individual. Thus the Court decided that the grantor should be treated as the owner of the trust corpus and of the income for the purposes of Section 22 (a). In reaching this conclusion, the Court reaffirmed (p. 334)

the frequently announced rule (*Corliss* v. *Bowers,* 281 U. S. 376, 378; *Burnet* v. *Wells,* 289 U. S. 670, 678; *Griffiths* v. *Commissioner,* 308 U. S. 355, 357-358; *Harrison* v. *Schaffner,* 312 U. S. 579) that legal technicalities or niceties of the law of trusts or conveyances should not be allowed to obscure the basic issue in tax cases, and pointed out (p. 334) that where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary, for purposes of determining whether the grantor is taxable on trust income under Section 22 (a).

The rule of the *Clifford* case has not been confined to the precise facts there presented. For example, the rule has been frequently applied in cases where the trust was not for a short term but for a long or indefinite term and also in cases where the corpus of the trust could never revert to the grantor. Thus in *Brown* v. *Commissioner,* 131 F. 2d 640 (C.A. 3d), certiorari denied, 318 U. S. 767, it was held that a grantor of a long-term trust was taxable on the income therefrom where she had the power to change the trustees and had reserved the power to change the shares of beneficial interest except that she could never direct payment to herself. See also *Stockstrom* v. *Commissioner* 148 F. 2d 491 (C.A. 8th); *Shapero* v. *Commissioner,* 165 F. 2d 811 (C.A. 6th); *Klein* v. *Commissioner,* 154 F. 2d 58 (C.A. 3d), certiorari denied, 328 U. S. 869; *Stockstrom* v. *Commissioner,* 151 F. 2d 353 (C.A. 8th); *Foerderer* v. *Commissioner,* 141 F. 2d 53 (C.A. 3d); *Hyman* v. *Nunan,* 143 F. 2d 425 (C.A. 2d); *Commissioner* v. *Buck,* 120 F. 2d 775 (C.A. 2d); *George* v. *Commissioner,* 143 F. 2d 837 (C.A. 8th), certiorari denied, 323 U. S. 778; *Funsten* v. *Commissioner,* 148 F. 2d 805 (C.A. 8th); and *Miller* v. *Commissioner,* 147 F. 2d 189 (C.A. 6th).

Moreover, the *Clifford* rule is not confined in its concept of a family group to those members of the family who dwell together under one roof but may include adults in the family living separately and it may also be applied to persons not related to the grantor. See *Cory* v. *Commissioner,* 159 F. 2d 391, 395 (C.A. 3d), and *Brown* v. *Commissioner, supra.* Furthermore, in applying the *Clifford* rule, it is not necessary to show that the grantor has any motive of tax evasion. *Hyman* v. *Nunan, supra,* p. 428. But it is significant if there is a close connection between the trustees and the grantors or if the grantors are trustees (*Gaylord* v. *Commissioner,* 153 F. 2d 408, 413 (C.A. 9th)), particularly if the grantors transfer stock or other property to the trust which is connected with the business in which they have a dominant interest or continue to exercise control over such business through the trust. See *Stockstrom* v. *Commissioner,* 148 F. 2d 491 (C.A. 8th); *Edison* v. *Commissioner,* 148 F. 2d 810 (C.A. 8th); *Funsten* v. *Commissioner, supra; Byerly* v. *Commissioner,* 154 F. 2d 879 (C.A. 6th); and *Klein* v. *Commissioner,* 4 T. C. 1195, affirmed, 154 F. 2d 58 (C.A. 3d).

When the trust agreement in the instant case and the facts surrounding it are interpreted in the light of the principles announced in the above cases, it is apparent that the rights and powers, which the taxpayers, a close family group, retained in the property as grantors, as trustees, and as principal beneficiaries, constitute such important incidents of ownership as to compel the conclusion that the taxpayers were the substantial owners of the trust corpus and income. The Tax Court's contrary conclusion is clearly erroneous.

Probably the most important of all the incidents of ownership is the right to benefit financially from the

property and this right the taxpayers had unquestionably retained for themselves individually as grantors. Under Article III (R. 34-35) each grantor had the unqualified right to receive the net income from the stock [3] contributed to corpus by him during his life, and the absolute power by written instrument filed with the trustees to appoint and dispose, to revoke a previous appointment, and to reappoint and dispose, during his life of his share of principal, including the stock dividends here in question, and income of the trust after his death. Thus, each grantor could, without restrictions of any kind, not only give his share of trust property to chosen beneficiaries but could also appoint the corpus to his estate or to his creditors.[4] He is thereby enabled during his life to borrow money or incur debts on the security of an irrevocable appointment to the lender or creditor. The right to have the income for life and to control the disposition of corpus and income after death, rights which each grantor possessed independently of the others, should be given great, if not controlling, weight in considering whether the taxpayers remained the substantial owners of their shares of the trust property, notwithstanding the superimposition of the trust form.[5] See

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[3] Such income does not include the stock dividends involved here, because Article VI (6)(a) of the instrument provides that stock dividends "shall inure to or fall upon principal" (R. 42), and so were retained by the trust when received.

[4] It should be noted that the absolute power of appointment, unlimited in any way, was reserved by each taxpayer, *as trustor*. Thus, in no event could it be limited by Article VIII which imposes upon the "beneficiaries" restrictions against assigning and anticipating their interests.

[5] For estate tax purposes the power of appointment alone held at death would make it necessary for the value of the income after death and of the corpus, including the stock dividends, to be included in the grantor's estate under Section 811 (f) of the Internal Revenue Code, and the reservation of the income for life alone makes the corpus transferred by the grantor includible in the grantor's gross estate under Section 811 (c) of the Code.

Gaylord v. *Commissioner, supra,* p. 413. Cf. *Commissioner* v. *Buck,* 120 F. 2d 775 (C.A. 2d); *Stockstrom* v. *Commissioner,* 148 F. 2d 491 (C.A. 8th); *Funsten* v. *Commissioner,* 148 F. 2d 805, 809 (C.A. 8th).

In *Commissioner* v. *Buck, supra,* p. 777, the Court of Appeals for the Second Circuit made this significant statement:

> Respondent argues, in effect, that the income is nontaxable to him because he has deprived himself of certain of his prior "bundle of rights", i.e. the rights to have the income paid directly to him, to use any of the income or principal for his personal consumption expenditures, and to make a testamentary disposition of the income or corpus. As we read the recent decisions of the Supreme Court, such a diminution of the congeries of rights and privileges called "ownership" is not sufficient to immunize the grantor of a trust from a tax on the income, in a case where, as here (to revert to our enumeration of significant factors), the beneficiaries are members of the donor's family and he has "income in excess of normal needs". In such a case, at any rate, a potent factor which melts off the grantor's insulation from income taxation is the donor's power to dispose of the income, for that power "is the equivalent of ownership of it." *Helvering* v. *Horst,* (1940) 311 U. S. 112, 118, * * * .

Here the bundle of economic benefits from the property was not diminished to the extent present in the *Buck* case, for, to reiterate, these taxpayers retained the income for their personal use during their lives, they retained the absolute, unrestricted power to dispose of income and corpus after death, and through this power of appointment, they could obtain financial benefits from the corpus during their lives. And these rights, of course, do not stand alone. Added to this are the family relationship of the taxpayers, their unity of

interest in controlling the two corporations, their triple role as trustors, trustees, and beneficiaries, and the other rights and powers reserved under the trust indenture, now to be discussed. Taken all together, these require the conclusion, we believe, that taxpayers remained the substantial owners of the corpus.

The eight grantors were a closely knit family group, composed of a mother, four adult daughters, and three adult sons. Together with Harry Chandler and the estate of a deceased daughter, they owned Chandis, a personal holding corporation, completely, and the grantors, together with Chandis and these same two other members of the family, owned a controlling interest in the Times-Mirror Company (4,022 shares out of a total of 5,760 shares outstanding). (R. 25.)

The eight grantors created a voluntary association among themselves by means of the trust with respect to the Times and Chandis stocks, as they stated in the trust indenture (R. 33) "for their best interests." They stated also (R. 32) that they deemed it for "their best interest" and for the "best interests" of the Times-Mirror Company and Chandis that there be a continuity and stability of policy and management. Their principal purpose, as pointed out by the Tax Court (R. 59), was to insure family control of the Times stock so that Norman Chandler, one of the grantors, would be assured its presidency and general managership. Thus, it is clear that the grantors, in creating the trust, were benefiting their individual interests and that, although they unquestionably gave up some managerial rights held individually over the stocks contributed to the trust, the benefits they were to gain were to them far more important than those surrendered. Otherwise, they of course would not have joined in creating the trust. In this connection it should be noted that each grantor's voice in controlling

each corporation was actually increased by means of the trust. Prior to its formation no one of the grantors owned a majority of the voting stock in either corporation. (R. 25.) The trust enabled each grantor to exchange his right to vote his individual shares for a voice in voting a larger block of shares, which represented controlling interests in each corporation.

Another fact of great significance is that, in addition to being grantors and life beneficiaries, with power to appoint income and principal after death, the taxpayers were also trustees. This triple role quite apparently means that the taxpayers dominated the trust completely and were virtual owners. In filling the three roles, the taxpayers could not and did not act in the disinterested manner that three distinct groups of persons might have done, nor were they required or expected to exercise the usual fiduciary powers of trustee. The instrument empowered them as trustees to construe its terms, their construction to be binding on all beneficiaries. They held the entire legal and equitable title as trustees, the beneficiaries having no title whatever and only the right to receive income as provided in the indenture and the corpus on termination of the trust. Also, individual trustees are authorized to deal with the trustees and to hold any office or position in any corporation with which the trustees may deal. Trustees are empowered to hold trust property in their own names, or in the names of one or more of their number without disclosing the fiduciary relationship. Their discretion was absolute, except where specifically limited, and when exercised conclusive on all persons.[6] These provisions gave taxpayers

[6] Sec. 2269 of the Civil Code of California (1949), provides:

§ 2269. *Discretionary powers.* A discretionary power conferred upon a trustee is presumed not to be left to his arbitrary discretion, but may be controlled by the proper court if not

as trustees important ownership rights and clearly show that the grantors were not imposing on themselves as trustees the usual fiduciary relationship, but that they were simply entering into a voting trust arrangement for their own benefit while at the same time retaining the essential incidents of ownership, including the financial benefits of the stock. Cf. *Gaylord* v. *Commissioner,* 153 F. 2d 408, 412 (C.A. 9th); *Edison* v. *Commissioner,* 148 F. 2d 810, 814 (C.A. 8th); *Stockstrom* v. *Commissioner,* 148 F. 2d 491, 495 (C.A. 8th).

Moreover, as trustees, they had powers to appoint trustees to fill vacancies in their number, to remove family trustees for cause, and to remove non-family successor trustees at will; to choose and employ agents, depositaries, brokers, attorneys, and others for the trust; to hold trust property in their own names as a group or individually without disclosing the trust; unanimously to increase the capital of, to issue bonds, and to change the voting and other preferences of their stocks in Chandis and Times-Mirror Company. Article VI also gave them numerous other powers, including the powers and discretions of absolute owners in the event the Times and/or Chandis stocks were disposed of, or the companies were wholly or partially liquidated. (R. 39-42.) All of these powers, as was stated in *Stockstrom* v. *Commissioner, supra,* p. 495, have far—

> more than a fiduciary significance or value in the nexus of previous ownership, family economics, technical dedication and continued control. This may particularly be true, it would seem, as to powers of control which are beyond those of con-

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reasonably exercised, unless an absolute discretion is clearly conferred by the declaration of trust. [Enacted 1872.]

Thus, it seems clear that no contingent beneficiary, contrary to the Tax Court's view, could have undertaken to control the trustees through any court proceeding. Taxpayers themselves of course as beneficiaries could hardly have questioned their acts as trustees.

> ventional fiduciaryship under traditional chancery concepts, and even more so as to powers which, though purporting to be granted also to subsequent trustees, can have no meaning or value actually, except in the settlor's pre-emptive position of dedicator of the property and the hold of the family relations. * * *

To be sure, the powers held as trustees could be exercised by the trustees acting as a group, unanimously or by majority, rather than individually. But in the circumstances here, that is not particularly significant, for as already noted this family group had long been interested in these corporations as the controlling group and had long acted together in business matters relating to them. The fact that they voluntarily pooled their stocks in a voting trust arrangement indicates that their interests were similar and that the benefits they gained from acquiring a voice in controlling the two corporations were far more important than the free voting rights as minority stockholders which they gave up.

Indeed, the direction to themselves as trustees to vote the stocks to carry out their *unanimous* desire to place Norman in the position of president and general manager of the Times-Mirror Company (R. 38) is convincing evidence that their interests were identical,[7]

[7] The Tax Court's easy assumption (R. 65) that Norman's interest was adverse to that of his co-grantors and co-trustees is not borne out by this provision or by any other evidence. Quite plainly all grantors were agreed, and so stated, that their best interests lay in perpetuating Norman as the executive in charge of the Times-Mirror Company. There is nothing to suggest that this view was not shared by all of them in the taxable years. Even if it were true that conflicting interests were to develop in later years, that could not affect this case for the issue here is simply whether the taxpayers' powers as trustees were so curtailed by the requirement for unanimous or majority agreement that they must not be weighed, along with other facts, in considering the matter of substantial ownership in the taxable years. If adverse interests developed later, of which there is no proof, that is irrelevant.

and that the trust requirement for unanimous (or majority) action of the eight trustees amounted to no real infringement of their control over the stocks. This conclusion is all the more required since the taxpayers, who had the burden of proof, offered no evidence showing or tending to show that their interests were not similar in the taxable years and that they would not vote harmoniously. It was clear error for the Tax Court to assume without proof that the requirement for joint action by the trustees curtailed taxpayers' proprietary rights to such an extent in the taxable years that they can no longer be regarded as substantial owners, when the inference required by the record is the contrary and when they retained the financial benefits from the property. See footnote 7, *supra*.

The Tax Court indicated that the taxpayers as trustees are "independent". (R. 60.) But surely they are not "independent" of themselves as trustors and as present beneficiaries, indeed the only beneficiaries with vested indefeasible interests. They plainly are not independent in the sense that the trustees in the usual non-family trust are, or that even family trustees who fill a real fiduciary position are. The Tax Court also stated (R. 62) that the trustees' powers "are fiduciary powers which must be exercised in good faith for the benefit of the beneficiaries and not for the personal benefit or aggrandizement of the trustors". But one must ask, for what beneficiaries? Apparently the Tax Court's answer was for the contingent beneficiaries, but the proper answer must be, for the grantors as the beneficiaries entitled to receive trust income for life with power to appoint the income and corpus after death to their estates or other appointees of their choice. The contingent beneficiaries had no

vested rights, since their right to take was dependent on each grantor's failing to exercise his power to appoint. The Tax Court could not properly ignore the grantors as principal and present beneficiaries, nor could it properly conclude that the grantors could not, and did not, act in their own interests when playing their roles as trustees. Moreover, as already pointed out, *supra,* many of the trustees' powers were of a nature indicating that the trustees were not intended really to be fiduciaries, the exercise of their discretionary powers was not controllable under California law (fn. 6, *supra*), and as a practical matter the trustees' acts would hardly be questioned by themselves as beneficiaries.

A further important power reserved by the taxpayers as grantors is by unanimous agreement "to modify, amend, construe, define or otherwise vary the terms of the provisions of Articles II, III, V, VI, VII, and IX" except that no modification is to be effective, directly or indirectly, "to change the provisions as to the duration of this trust or the initial character of the Trust Estate, as provided in Articles I, IV, and VIII." (R. 47.) Under this power the grantors acting in unison could change the contingent beneficiaries named in Article III to receive corpus and income in the event they did not exercise their powers of appointment; they could change the methods of appointing and removing trustees set out in Article V; they could enlarge or alter their powers as trustees under Article VI; and they could further limit their liabilities as trustees under Article VII. Their full right to do these things seems unquestionable so long as they did not change the duration of the trust or the *initial* character of the trust estate. And we believe it plain that, under the reserved right to amend Article

VI, the grantors could actually provide that the stock dividends here in question are income distributable to them as life beneficiaries. Cf. Paragraph (f)(6) of Article VI. (R. 42-43.) The power to take the stock dividends of course is virtually the same as ownership, as this Court recognized in *Gaylord* v. *Commissioner, supra.*

The Tax Court thought (R. 63) that the power to amend and take down the stock dividends did not exist, in part because they were a part of the shares of stock within the meaning of Article I which was not subject to amendment. This view is not supportable. The stock dividends were not shares "delivered to the Trustees hereunder" within Article I (R. 33), since that reference is to the particular shares delivered to the trustees on formation of the trust, which comprise the trust estate. The shares meant in Article I are enumerated just prior to that article in the trust indenture (Ex. 1-A), and they do not include subsequent stock dividends. Obviously, the stock dividends were not part of the initial trust estate and to distribute them would not change its initial character or terminate the trust. The Tax Court also stated (R. 63) that the grantors' powers could "be exercised only to maintain such a proportionate interest as is now represented in" the Times and Chandis companies. But it failed to note that the quoted language is found in Article VI (2) (R. 37-38) of the trust instrument and that it follows and apparently relates only to powers granted to the trustees to borrow upon, pledge, or otherwise dispose of any interest in the "said" Times and Chandis shares, i.e., those shares contributed to the trust initially. Thus, the proportionate interest requirement was not intended apparently to relate to any stock other than the initial stock or to limit the grantors in exercising

their reserved power to amend.[8] In any case even if applicable to the grantors' reserved power to amend, the proportionate interest requirement is found in Article VI, which was subject to the power to amend. Since it could be eliminated or amended, it constitutes no restriction on the grantors' rights by amendment to take down the stock dividends.

In enumerating the things which an individual grantor could not do with respect to his stock after creation of the trust (R. 60-61), the Tax Court makes many obvious errors. For example, a trustor can, contrary to the Tax Court's statement, receive cash dividends on the Chandis stock, since these constitute trust income under Article VI (6) (a) which the trustor is entitled to receive. The statement (R. 61) that a trustor is not entitled to "sprinkle" trust income during his lifetime, as in *Commissioner* v. *Buck,* 120 F. 2d 775 (C.A. 2d), is inaccurate; it overlooks the fact that each trustor here is entitled to receive all trust income from his property and, having received it, could sprinkle it as he wished. Furthermore, the Tax Court fails to observe that each trustor reserved the absolute power to sprinkle both income and corpus after his death as he desired, even to his own estate. This case is much stronger for taxability than was the *Buck* case where Buck only controlled the sprinkling of the income among others but could not receive it himself. The statement that a trustor had no right, individually or as trustee, to hold trust assets without disclosing the trust (R. 61) is in violation of Article VI (6)(b),

[8] In fact, the taxpayers acting either as trustees or grantors had already changed the original proportion of stock ownership in Chandis before any stock dividend was received. (R. 48.) The trust in 1937 had acquired in some manner 884 shares of Chandis preferred stock (R. 47), representing 1,263 votes (R. 63), and this of course destroyed the trust's original proportionate interest in Chandis.

xpressly giving the trustees power to hold trust property in the names of one or more of their number without disclosing the fiduciary relationship. Other errors ould be pointed out. In addition, throughout the vhole statement, the Tax Court fails to allow for the ndividual grantor's position as a member of a close amily unit having the same interests and acting together in the taxable years, as a result of which the rantor actually held the power as one of the grantors nd trustees to do most of the things mentioned by the Tax Court. The *Clifford* case and those following it, eretofore cited, recognize that the actualities are to govern in determining the question of substantial wnership, and in the harmonious family unit here here was little practical difference in powers exercisable by the eight trustees together and similar powers exercisable by a single grantor-trustee. This view is supported by the dissenting opinion in the Tax Court (R. 70), which obviously and correctly regarded the power of the trustors to modify Article VI (including the power, as shown above, to treat the stock dividends as income distributable to them), as an effective power in each trustor to do so.

Commissioner v. *Bateman,* 127 F. 2d 266 (C.A. 1st), which the majority of the Tax Court thought apposite here (R. 59-60), is we submit clearly distinguishable. In that case the taxpayer-grantor created a trust in contemplation of her intended marriage. Ninety-five percent of the income was distributable during the grantor's lifetime, $3,000 annually to the intended husband and the balance to the grantor. The remaining five percent of the income was to be added to corpus over which (except for $50,000 which was distributable to the husband if he survived the grantor) the grantor reserved a general power of appointment to take effect at her death, with gifts over in default

of appointment. The husband had died before the taxable year there involved. The Court of Appeals for the First Circuit held that the grantor was not taxable on the five percent of income added to corpus under Section 22 (a) (pp. 269-275) but stated (p. 275):

> We reach this conclusion not without some misgivings, in view of the uncertainty as to the proper implications to be drawn from the decisions we have reviewed.

We think that there is considerable doubt, which was shared by the court itself, that the court there reached the correct conclusion but in any event the *Bateman* case did not involve the same factual situation as does the present case and consequently, if it is assumed to be correct, it does not dictate the same conclusion in this case. In the *Bateman* case, the trust corpus was transferred to two independent and disinterested third-party trustees who were given full powers of management and control, including the right to vote the trust stocks, and power to select their successors or co-trustees. They were in Massachusetts, while the grantor lived in England during the taxable years. And Lady Bateman was not able, as are the grantors here, to take down the income added to corpus by amending the trust instrument to make it income distributable to her as income beneficiary. Nor did the corpus of the trust consist of stocks in corporations which the grantor controlled, as here. In short, the *Bateman* case presented the issue of whether the reservation of the income for life with power to appoint corpus after death, without more, amounted to such substantial ownership as to make the grantor taxable on the income under Section 22 (a). The instant case possesses so many additional factors, pointing to substantial ownership, that it can not be governed by the *Bateman* decision.

As the four dissenting judges pointed out (R. 70), he present case is more analogous to *Klein* v. *Commissioner,* 4 T.C. 1195, affirmed *per curiam,* 154 F. 2d 58 (C.A. 3d), certiorari denied, 328 U. S. 869. Klein did not reserve the right to receive the trust income as here. Instead the income was to be accumulated for twenty years or until the death of Klein or his wife. At the end of the accumulation period if Klein was alive, the income was payable to his wife or to such persons as Klein should select. Klein also reserved the power to designate the persons to take the corpus upon termination of the trust at his death or that of his wife. He was one of the two co-trustees, with broad administrative powers over the property. He had power to remove his co-trustee, who was a close business associate, and he dominated the corporation whose stock composed the trust corpus. Thus, that case has many points of similarity to the case at bar and the decision there that Klein was taxable under Section 22 (a) on the income added to corpus is pertinent in this case.

It is submitted that the Tax Court clearly erred in not finding that taxpayers' bundle of rights in the trust corpus and income was so substantial as to require the conclusion that they remained the real owners thereof and are taxable on the stock dividends under Section 22 (a).

II

The Tax Court Erred in Not Holding That the Grantors of the Trust Here Are Subject to Tax under Section 167 of the Revenue Act of 1938 and the Internal Revenue Code, on the Stock Dividends Received by the Trust During the Taxable Years

The Tax Court also held that the stock dividends (which are admittedly taxable income in the years received) were not taxable to the grantors under Sec-

tion 167 of the Revenue Act of 1938 and the Internal Revenue Code, Appendix, *infra.* (R. 66.) That section requires the grantor of a trust to treat any part of the trust income as his own for income tax purposes where such part of the income—

> (1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or
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> (2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; * * *

We think it clear that this section requires the taxation of the stock dividends to the grantors because the stock dividends are trust income which may, in the discretion of the grantor or persons not having a substantial adverse interest in the disposition of the stock dividends, be distributed or be held for future distribution to the grantor.

1. The power reserved by the eight grantors to amend the trust as to certain articles, including that providing that stock dividends inure to corpus, as already shown under point I, enabled the grantors to provide that the stock dividends are income with the result that they would become distributable to the grantors under Article III. Thus, the stock dividends may in their own discretion be distributed to the grantors or may be held for future distribution to them. The fact that the eight grantors must unanimously agree to amend and make the dividends distributable to them has no significance at all for purposes of Section 167, because the section in terms refers only to persons not having a substantial adverse interest in the disposi-

tion of the income. Since each grantor held the right to receive his share of trust income and had complete and exclusive control over the disposition of his share of the trust corpus, including the stock dividends, through his absolute power to appoint, no other grantor could possibly be regarded as having an adverse interest in the disposition of the dividends, whether their status be corpus or income. There was no possibility that any grantor could have an interest in any other grantor's share of corpus as a contingent beneficiary under the gifts-over in default of appointment. (R. 35.) No grantor could qualify as a *living* heir-at-law at the termination of the trust, since the trust would not terminate until the last survivor of 21 named persons, including all eight grantors, had died. (R. 35.) Even if the condition that only living heirs-at-law are possible beneficiaries could be met, there were other contingencies (i.e., the non-exercise of the power of disposition, the prior death of all issue of the grantor, and their classification as an heir-at-law under California law in force on the date of the grantor's death), to be met before any grantor could qualify as a beneficiary of any other grantor's corpus, and such a remote contingent interest could not be considered as substantial. Cf. *Cushing* v. *Commissioner,* 38 B.T.A. 948.

2. The power to appoint the corpus, including the stock dividends, also requires the conclusion that the dividends may be distributed or may be held for future distribution to each grantor in his discretion. Since each grantor held this power alone, there is no question here as to whether the interests of the other grantors are substantially adverse. Under the absolute power to appoint, as already shown, the grantor could name his estate or his creditors to receive the corpus, including the stock dividends, on termination of this trust

after his death, and because of his power to do this he would be enabled to realize the value of the dividends during his lifetime.

In *Commissioner* v. *Bateman,* 127 F. 2d 266 (C.A. 1st), the court rejected the view that income added to the corpus which was subject to the grantor's general power of appointment effective at her death was not income which could be distributed to the "grantor" within the meaning of Section 167, citing *Wilson* v. *Commissioner,* 42 B.T.A. 1260. In the *Wilson* case, the Board held (pp. 1265-1266) that for purposes of Section 167 "future distribution to the grantor" did not include a remote possibility of future distribution to the grantor and did not include future distribution "to his estate". The *Wilson* decision was reversed in *Commissioner* v. *Wilson,* 125 F. 2d 307, 310-311 (C.A. 7th), apparently for the reason that there was a possibility of future distribution to the grantor during his life but if this did not occur his estate would get the income in question in any event. Thus, the Seventh Circuit's decision to some extent supports the view that future distribution to the estate of a grantor will satisfy Section 167.

However, our position does not depend on a possible reversion to the grantor's estate dependent on circumstances beyond his control as in the *Wilson* case. Here the grantor could, by appointing his estate to receive the corpus, control its use for payment of his obligations, the benefits from the creation of which he could enjoy during his lifetime. Thus, we think the *Bateman* opinion erroneously treated that case as completely analogous to the *Wilson* situation, and that in any event it failed to consider the realities which exist in the case of a general power to appoint corpus, including income added thereto, to take effect at death, by means of which the grantor may be able to enjoy

the equivalent of the income during his life. Moreover, if such income is not regarded as taxable under Section 167 merely because it can not be appointed to the grantor personally but only to his estate, the way is open for a grantor with a general power to escape tax and at the same time to enjoy the economic benefit of the accumulated income during his life on the strength of his appointment of the income to his estate. We think the terms of Section 167 are not to be so easily avoided.

It is submitted that the Tax Court erred in failing to hold that the stock dividends are taxable to the taxpayer-grantors under Section 167.

CONCLUSION

The decision of the Tax Court should be reversed.

Respectfully submitted,

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APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

Sec. 22. Gross Income.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

Sec. 167. Income for Benefit of Grantor.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question".

The corresponding sections of the Internal Revenue Code contain substantially the same provisions as those above.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

* * * * *

ART. 167-1. *Trusts in the income of which the grantor retains an interest.*—(a) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(b) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is

applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor. A bare legal interest, such as that of a trustee, is never substantial and never adverse.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of sec-

tion 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitely of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

* * * * *

The above provisions of Regulations 101 are substantially the same as Section 19.167-1 of Regulations 103.

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